TOKIO MARINE
HCC

HCC International Insurance Company PLC
Annual Report and Financial Statements

2016

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Company Information

Directors

S A Button

B J Cook (Chief Executive Officer)

T J G Hervy

N I Hutton-Penman

H Ishii (appointed 1 November 2016)

K L Letsinger

N C Marsh (non-executive Chairman)

H-D Rohlf (non-executive)

C Scarr (non-executive)

W R Treen (non-executive) (resigned 31 March 2016)

Company secretaries

D R Feldman

J L Holliday

N J Walklett

R L Hughes (resigned 29 July 2016)

Registered number

1575839

Registered office

1 Aldgate London EC3N 1RE

Independent auditors

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London SE1 2RT

Strategic Report

The directors of HCC International Insurance Company PLC ('HCCII') present their strategic report for the year ended 31 December 2016.

Principal Activities

The principal activity of the Company is the transaction of general insurance and reinsurance business in the United Kingdom and Continental Europe where it benefits from the European Union Freedom of Services charter to write across the European Union member states. The Company is the flagship carrier for TMHCC Group's international operations ('International Group'). International Group business is also written on two other platforms; Houston Casualty Company London Branch ('HCL') and Syndicate 4141 (the 'Syndicate'). The Company operates from a number of offices across the UK and also has branches in Spain, Ireland, France, Switzerland, Germany, Italy and Norway. The Company is authorised by the Prudential Regulation Authority and regulated by both the Financial Conduct Authority and the Prudential Regulation Authority.

HCCII's ultimate parent Company is Tokio Marine Holdings, Inc. ('TMHD') whose head office is located in Tokyo, Japan. TMHD is a leading international insurance group with offices worldwide. As of 31 December 2016, TMHD had total assets of YEN ¥22.1 trillion (2015: YEN ¥21.9 trillion) and shareholders' equity of YEN ¥3.4 trillion (2015: YEN ¥3.6 trillion). TMHD's major insurance companies have a financial strength rating of A+ (Stable) from Standard & Poor's Financial Services LLC.

TMHD acquired HCC Insurance Holdings, Inc. ('TMHCC') on 27 October 2015 ('the Acquisition'). Prior to that date, the Company's ultimate parent was HCC whose head office is located in Houston, Texas. HCC is now an intermediate holding Company of HCCII and continues to manage the TMHCC group.

The International Group underwriters write business on the international platforms based on prescribed rules which determine which carrier is utilised. Licensing, distribution or client choices are the principle determinants of the platform utilised. Lines underwritten include Property Treaty, Property Direct and Facultative, Accident and Health, Energy and Marine, Professional Risks, Financial Lines, Credit and Political Risk, Surety and Contingency. Financial Lines is underwritten through TMHCC Global Financial Products S.L. ('TMHCCG'), a wholly owned subsidiary of TMHCC. The Company has continued to grow in recent years, despite difficult trading conditions, as TMHCC makes use of the Tokio Marine franchise and continues to add to its international product offerings.

Strategy and Market Conditions

The Company's business philosophy and strategic focus is to underwrite profitable business which includes careful risk selection and reinsurance purchasing in order to preserve shareholder's equity and meet its target risk adjusted return on capital. Underwriting is concentrated in selected, narrowly defined, lines of business where consistent underwriting profit can be achieved. The Company's experienced underwriting personnel with access to, and expertise in, the insurance and reinsurance marketplace has enabled the Company to achieve its strategic objectives. The current rating environment for the London Market lines of business (principally Property Treaty, Property Direct and Facultative, Accident and Health and Energy and Marine) remains extremely challenging as a result of excess capacity in the market leading to decreasing premium volumes. The Specialty lines of business (Professional Risks, Financial Lines, Credit and Political Risk, Surety and Contingency) are also subject to the challenging rating conditions, however they continue to grow organically due to a combination of unique distribution channels and disciplined risk selection. A weaker pound has affected the results of the Company and in particular the Specialty lines as a substantial proportion of this business is in Sterling and this financial statement is prepared in US Dollar, the functional currency of the Company.

The business mix of the Company in 2016 has changed compared to 2015 reflecting a decrease in volume from London Market Lines of business reflective of market conditions; this has been offset by organic growth in the Specialty Lines. 2016 was free of large catastrophes resulting in better than expected profit of the London Market lines of business. The core lines of the Specialty segment performed well and in line or better than expectations. This good performance was dampened by the Lifestyle Travel Medical business (which the Company entered in 2015 and will exit from January 2017). Additionally, the Credit and Political Risk business, a long standing and good performing class of business, has had challenging results this year resulting from difficult market conditions. The Company continues to benefit from the strong financial strength rating and backing of its parent and an S&P rating of AA- which remains a significant differentiator and a key selling point in many of the markets in which the Company operates, particularly in the Surety and Financial Lines.

Results and Performance

The Company made a net profit for the financial year of $138.1m (2015: $41.2m) and includes a balance on the technical account for general business of $175.0m (2015: $102.3m). The technical account includes the release of the equalisation provision which is no longer required under Solvency II effective from 1 January 2016, totalled $96.2m (2015: $16.1m additional provision increase) and investment income of $24.2m (2015: $22.4m) has also been recognised in the technical account.

The Balance on the technical account excluding the release of the equalisation provision and investment income is $54.6m (2015: $95.9m). Adjusting for the impact of FX ($6.7m), the technical result was $32.9m lower than 2015 driven by the following; London Market underwriting profits of $12.8m (2015: $27.1m) reflective of less net written premium due to current market conditions; profits from TMHCC Credit business of $3.1m (2015: $12.7m) driven by some poor loss experience in 2016 reflective of the global economic conditions within its markets; $5.9m loss from Lifestyle Travel Medical business which has been exited (2015: $0.11m loss) and $45.3m (2015: $42.4m) profit from the core Specialty business.

The catastrophe environment was benign in 2016 and 2015; prior year reserve releases contributed $15.9m (2015: $20.8m) to the technical result.

The decrease in premium resulting from the London market conditions combined with the growth in the Specialty Lines resulted in a change in business mix and a higher net loss ratio. This combined with lower prior year reserve releases and additional current year provisioning for TMHCC Credit and Lifestyle have produced a net loss ratio of 40.5% (2015: 31.9%).

The reported Non-technical profit was $1.9m (2015: $34.5m loss). This is comprised of unrealised net gains and losses on investments of $6.4m gain (2015: $13.0m loss) which is reflective of overall better investment market conditions; $5.1m gain (2015: $2.6m loss) from revaluation, and other charges of $9.5m (2015: $18.9m). 2015 included corporate and employee compensations costs related to the Acquisition.

Key Performance Indicators		2016	2015
Gross premiums written		$548.6m	$536.4m
Net premiums written	Net of reinsurance	$433.1m	$409.5m
Underwriting result	Balance on technical account (before investment income and equalisation provision)	$54.6m	$95.9m
Net loss ratio	Ratio of net incurred claims (excluding equalisation reserve) to net earned premiums	40.5%	31.9%
Net combined ratio	Ratio of total technical charges (before investment income and equalisation provision) to net earned premiums	87.4%	75.4%
Investment return	Total investment return (excluding FX from revaluation of investments)	$30.6m	$9.4m*
Cash and investments	Excluding investment in subsidiaries and land and buildings	$1,172.1m	$1,099.2m
Total shareholders' funds		$626.9m	$479.4m

*Restated

Overall, the directors are satisfied with the Company's operations and its financial position as at the end of the year.

Gross Premium Written

Gross premium written increased $12.2m to $548.6m in 2016 (2015: $536.4m). After eliminating the effect of the stronger US$ in 2016, underlying premium increased $42.8m (average Sterling and Euro rates of exchange have weakened against the dollar by 11.8% and 0.9%, respectively). The $42.8m increase was driven by the growth in the Specialty business largely due to Surety and Lifestyle business (which is included in 'Other' in the GWP table below), offset by a decrease in London Market business which is in line with the rating environment and general soft market conditions.

The foreign exchange effect on gross premium written is shown in the table below:

Gross Premium Written	2016 GPW $'m	2015 GPW $'m	Increase/(Decrease) $'m	Increase/(Decrease) % change	2015 GPW at 2016 rate $'m	Increase/(Decrease) $'m	Increase/(Decrease) % change
Financial Lines	124.6	125.3	(0.7)	(0.6)%	124.0	0.6	0.5%
Professional Risks	112.0	116.5	(4.5)	(3.9)%	104.4	7.6	7.3%
Credit & Political Risk	79.4	88.6	(9.2)	(10.4)%	83.5	(4.1)	(4.9)%
Surety	76.2	66.8	9.4	14.1%	61.8	14.4	23.3%
Other	61.5	16.8	44.7	266.1%	13.6	47.9	352.2%
Total Specialty Segment	**453.7**	**414.0**	**39.7**	**9.6%**	**387.3**	**66.4**	**17.1%**
Marine & Energy	35.1	54.8	(19.7)	(36.1)%	54.2	(19.1)	(35.2)%
Property Treaty	45.4	51.0	(5.6)	(11.0)%	48.3	(2.9)	(6.0)%
Property D&F and A&H	14.5	16.6	(2.1)	(12.3)%	16.0	(1.5)	(9.4)%
Total London Market	**95.0**	**122.4**	**(27.4)**	**(22.4)%**	**118.5**	**(23.5)**	**(19.8)%**
Total	**548.7**	**536.4**	**12.3**	**2.3%**	**505.8**	**42.9**	**8.5%**

Speciality

Financial Lines gross premium written has remained relatively stable at $124.6m (2015: $125.3m) with minimal currency impact. The Financial Lines business includes principally Directors and Officers ('D&O') liability and Transaction Risk Insurance ('TRI') business. Difficult market conditions in the D&O line of business has resulted in a reduction in gross premium written which has been largely offset by growth in TRI business.

Professional Risks gross premium written has decreased 3.9% to $112.0m (2015: $116.5m), excluding the effect of currency increased by 7.3%. The business is comprised of Professional Indemnity and Liability business where organic growth through product development, new business initiatives and increased regional presence have continued year on year. The Professional Indemnity business is high volume, low premium business underwritten through regional brokers with a focus on client service, the target clients being smaller, lower risk businesses. The Liability business comprises niche products covering lower risk trades and is made up of single risk and select affinity business.

Credit & Political Risk gross premium written has decreased 10.4% to $79.4m (2015: $88.6m), 4.9% excluding the effect of currency. The market has become increasingly challenging due to growing competition and fewer insolvencies encouraging rate reductions. The UK whole turnover Credit business where high service standards position the Company well with clients, has historically experienced good retention levels and this remains high. In 2016, the Company actively sought to widen its niche UK whole turnover Credit distribution network by targeting larger clients and successfully integrating a new Credit underwriting team. The Excess Credit and Political Risk business has maintained its market position with continued benefit from the Company's financial rating.

Surety gross premium written has increased 14.1% to $76.2m (2015: $66.8m); 23.3% excluding the effect of currency. The Company's position in the market and its strong S&P rating provides good opportunities to sell performance bonds & other bond products supporting large multi-national companies involved in significant infrastructure projects.

Other mainly represents Travel Medical business written through coverholders in the UK which had growth of $44.7m in the year to $61.5m and has been discontinued from 1 January 2017.

London Market

Marine & Energy gross premium written decreased 36.1% to $35.1m (2015: $54.8m) with little effect of currency. The Energy market continues to remain challenging due to low oil prices and overcapacity in the insurance market contributing to the low level of income. Continued low oil prices since mid-2014 has contributed to fewer new projects being implemented along with scaling back of major drilling operations, which had a bigger impact in 2016. The difficult environment will likely continue for the foreseeable future with possible further contraction of premium volumes.

Property Treaty gross premium written decreased 11.0% to $45.4m (2015: $51.0m), 6.1% excluding the effect of currency. This is the result of continued softening of the market affecting rates and the non-renewal of business which has not met pricing requirements.

Property Direct & Facultative and Accident & Health gross premium decreased 12.3% to $14.5m (2015: $16.6m), 9.2% excluding the effect of currency. The decrease is due to the continued trend of soft market conditions, increased capacity and competition in this class of business as a result of benign loss experience. These all make writing conditions more challenging for the foreseeable future.

Investment Performance

The investment function is overseen by the Investment Committee which operates under terms of reference set by the Company's Board. The Committee is responsible for preparing, in conjunction with the Company's Investment Managers, the Investment Policy for approval by the Board. It is also responsible for monitoring investment performance and recommending the appointment of investment managers.

New England Asset Management was investment manager for the US Dollar, Sterling, Euro and CHF funds throughout the year. The funds consist primarily of a portfolio of highly rated Corporate Bonds, which are BBB rated and above, including Bonds guaranteed by the US, UK and German governments. The average duration of the aggregate portfolios at the year-end was 4.01 years (2015: 3.75 years).

Future Outlook

The Company continues to consider profitable opportunities in complimentary and new lines of business, through growth of teams, expansion into new territories, potential acquisitions and utilisation of the Tokio Marine global network.

Dividends

Dividend paid during the year totalled $nil (2015: $8.7m). No final dividend is recommended.

On behalf of the board

B J Cook
Chief Executive Officer

1 Aldgate
London EC3N 1RE
8 May 2017

Directors' Report

The directors present their Directors' Report and the audited financial statements of the Company for the year ended 31 December 2016.

Directors

The directors set out below have held office from 1 January 2016 to the date of this report unless otherwise stated:

S A Button

B J Cook (Chief Executive Officer)

T J G Hervy

N I Hutton-Penman

H Ishii (appointed 1 November 2016)

K L Letsinger

N C Marsh (non-executive Chairman)

H-D Rohlf (non-executive)

C Scarr (non-executive)

W R Treen BSc, FIA (non-executive) (resigned 31 March 2016)

Matters disclosed in the Strategic Report

Required disclosures in the Directors' Report; Principal activities, location of branches outside the UK, recommended dividend (NIL) and the Future outlook have been disclosed in the Strategic Report.

Independent Auditors

In connection with new EU requirements, the Company's Board will be undertaking a tender for external audit services for the Company's financial year ending 31 December 2017, subject to approval at the Company's Audit Committee meeting.

Statement of Disclosure of Information to Auditors

Each of the persons who are a director at the date of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditors are not aware; and
- the director has taken all steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Statement of Directors' Responsibilities

The directors are responsible for preparing the financial statements in accordance with applicable law and regulations. Company law requires the directors to prepare financial statements for each financial year. Under that law, the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under Company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board

B J Cook
Chief Executive Officer

1 Aldgate
London EC3N 1RE
8 May 2017

Independent Auditors' Report to the Members of HCC International Insurance Company Plc

Report on the financial statements

Our opinion
In our opinion, HCC International Insurance Company Plc's financial statements (the 'financial statements'):

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited
The financial statements, included within the Annual Report, comprise:

- the profit and loss account and statement of comprehensive income for the year ended 31 December 2016;
- the balance sheet as at 31 December 2016;
- the statement of changes in shareholders' equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is United Kingdom Accounting Standards, comprising FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland', and applicable law (United Kingdom Generally Accepted Accounting Practice).

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration
Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 13, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)'). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Paul Pannell (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
8 May 2017

Profit and Loss Account

For the year ended 31 December 2016

Technical account – general business	Note	2016 $'000s	Restated 2015 $'000s
Earned premiums, net of reinsurance			
Gross premiums written	6	548,630	536,394
Outward reinsurance premiums		(105,550)	(126,864)
Net premiums written		443,080	409,530
Change in the gross provision for unearned premiums		2,103	(20,767)
Change in the provision for unearned premiums, reinsurers' share		(13,409)	1,768
Change in the net provision for unearned premiums		(11,306)	(18,999)
Earned premiums, net of reinsurance		431,774	390,531
Earned investment income transferred from the non-technical account	7	24,157	22,434
Total technical income		455,931	412,965
Claims incurred, net of reinsurance			
Claims paid:			
– gross amount		297,737	176,876
– reinsurers' share		(132,932)	(56,652)
Net claims paid		164,805	120,224
Change in the provision for claims:			
– gross amount		(2,755)	42,574
– reinsurers' share		12,668	(38,328)
Change in the net provision for claims		9,913	4,246
Claims incurred, net of reinsurance		174,718	124,470
Net operating expenses	8	202,448	170,118
Change in equalisation provision		(96,225)	16,057
Total technical charges		280,941	310,645
Balance on the technical account for general business	6	174,990	102,320

All results derive from continuing operations.

Non-technical account	Note	2016 $'000s	Restated 2015 $'000s
Balance on the technical account for general business		174,990	102,320
Investment income	7	27,878	24,699
Earned investment income transferred to general business technical account	7	(24,157)	(22,434)
Unrealised gains on investments	7	8,659	3,523
Unrealised losses on investments	7	(2,237)	(16,555)
Investment expenses and charges	7	(3,743)	(2,217)
Foreign exchange losses from revaluation of investments	7	(25,086)	(15,881)
Foreign exchange gains on revaluation of monetary items other than investments	7	30,203	13,321
Other charges	12	(9,546)	(18,981)
Profit on ordinary activities before tax and exceptional items		176,961	67,795
Exceptional items	13	–	(8,233)
Profit on ordinary activities before tax		176,961	59,562
Tax on profit on ordinary activities	14	(38,863)	(18,334)
Profit for the financial year		138,098	41,228

Statement of Comprehensive Income

For the year ended 31 December 2016

	Note	2016 $'000s	Restated 2015 $'000s
Profit for the financial year		138,098	41,228
Distributions from subsidiary undertakings	17	–	(32)
Revaluation of subsidiary undertakings	17	662	948
Total comprehensive income		138,760	42,144

Balance Sheet

For the year ended 31 December 2016

	Note	2016 $'000s	Restated 2015 $'000s
Assets			
Intangible assets			
Goodwill	15	7,725	9,270
Investments			
Land and buildings	16	239	239
Investment in subsidiary undertakings	17	8,208	7,501
Other financial investments	18	1,110,198	1,062,895
		1,118,645	1,070,635
Reinsurers' share of technical provisions			
Provision for unearned premiums		51,385	66,554
Claims outstanding		281,675	293,688
		333,060	360,242
Debtors			
Debtors arising out of direct insurance operations			
– Policyholders		22,957	27,209
– Intermediaries		75,401	59,271
Debtors arising out of reinsurance operations		23,075	41,412
Other debtors	19	50,294	61,770
		171,727	189,662
Other assets			
Tangible assets	20	2,684	2,725
Deposits from third parties		57,812	48,011
Cash at bank and in hand		61,941	36,350
		122,437	87,086
Prepayments and accrued income			
Accrued interest and rent		7,903	8,811
Deferred acquisition costs	8	73,148	74,394
Other prepayments and accrued income		31	182
		81,082	83,387
Total assets		1,834,676	1,800,282

Balance Sheet

For the year ended 31 December 2016

	Note	2016 $'000s	2015 $'000s
Liabilities			
Capital and reserves			
Called up share capital	21	233,242	224,405
Revaluation reserve		8,208	7,546
Profit and loss account		385,521	247,423
Total shareholders' funds		626,971	479,374
Technical provisions			
Provision for unearned premiums		281,353	289,977
Claims outstanding		712,314	750,029
Equalisation provision		–	96,225
		993,667	1,136,231
Creditors			
Creditors arising out of direct insurance operations		12,696	12,624
Creditors arising out of reinsurance operations		51,447	58,294
Other creditors including taxation and social security	22	48,250	27,030
Deposits from third parties		57,812	48,010
		170,205	145,958
Accruals and deferred income		43,833	38,719
Total liabilities		1,834,676	1,800,282

The financial statements on pages 14 to 50 were approved by the Board of Directors and were signed on its behalf by

K L Letsinger
Director
8 May 2017

Statement of Changes in Shareholders' Equity

For the year ended 31 December 2016

Capital and reserves	Called up share capital $'000s	Revaluation reserve $'000s	Other reserves $'000s	Profit and loss account $'000s	Total shareholders' equity $'000s
At 1 January 2016	224,405	7,546	–	247,423	479,374
Profit for the financial year	–	–	–	138,098	138,098
Issued share capital	8,837	–	–	–	8,837
Revaluation of subsidiary undertakings	–	662	–	–	662
At 31 December 2016	233,242	8,208	–	385,521	626,971

Capital and reserves	Called up share capital $'000s	Revaluation reserve $'000s	Other reserves $'000s	Profit and loss account $'000s	Total shareholders' equity $'000s
At 1 January 2015	224,405	6,630	310	214,895	446,240
Profit for the financial year	–	–	–	41,228	41,228
Share based compensation charge on exercise	–	–	(310)	–	(310)
Dividends paid	–	–	–	(8,700)	(8,700)
Revaluation of subsidiary undertakings	–	948	–	–	948
Distributions from subsidiary undertakings	–	(32)	–	–	(32)
At 31 December 2015	224,405	7,546	–	247,423	479,374

1. General information

HCC International Insurance Company PLC ('the Company') is authorised by the Prudential Regulation Authority ('PRA') and regulated by both the Financial Conduct Authority and the PRA. The principal activity of the Company is the transaction of general insurance business in the United Kingdom and Continental Europe where it benefits from the European Union Freedom of Services charter to write across the European Union member states. The Company operates from a number of offices across the UK and also has branches in Spain, Ireland, France, Switzerland, Germany, Italy and Norway. The Company is a private Company limited by shares and is incorporated in England. The address of its registered office is 1 Aldgate, London EC3N 1RE.

2. Statement of compliance

The individual financial statements of the Company have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" ('FRS 102'), Financial Reporting Standard 103, 'Insurance Contracts' ('FRS 103') and the Companies Act 2006.

3. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

a. Basis of preparation

These financial statements have been prepared in conformity with FRS 102 & 103. FRS 102 & 103 requires financial statement disclosure about the use of certain critical accounting estimates for which management has exercised judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

Restatement reclassification of comparatives

Comparative amounts have been adjusted to conform to changes in accounting policies and presentation in the current year.

b. Going concern

Having assessed the principal risks, the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

c. Exemptions for qualifying entities under FRS 102

As allowed by FRS 102, the Company has applied certain exemptions as follows:

i. preparing group financial statements. The financial statements present information about the Company as an individual undertaking and not about its group, except for accounting for its investment in subsidiary undertakings at current net asset value (see Note 17);

ii. preparing a statement of cash flows; and

iii. related party disclosures.

d. Foreign currency

The Company's accounting records are maintained in US Dollars, which is the Company's functional and presentation currency. Foreign currency transactions are recorded using the spot exchange rates at the dates of the transactions into the functional currency. At each period end, foreign currency monetary assets and liabilities are revalued using the closing rate. For this purpose all assets and liabilities arising from insurance contracts (including unearned premiums, deferred acquisition costs and unexpired risks provisions) are monetary items. Differences arising on the revaluation of foreign currency amounts to the functional currency are recognised in the non-technical profit and loss account.

e. Insurance contracts

i. Classification of insurance and investment contracts

The Company issues insurance contracts that transfer significant insurance risk. The Company does not issue investment contracts that transfer financial risk.

ii. Insurance contracts

Results are determined on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance, as follows:

a. Premiums written

Premiums written relate to business incepted during the year, together with adjustments made in the year to premiums written in prior accounting periods. Premiums are shown gross of brokerage payable and exclude taxes and duties levied on them. Estimates are made for unreported, or pipeline, premiums representing amounts due to the Company not yet notified. Outward reinsurance premiums are accounted for in the same accounting year as the premiums for the related inwards business.

b. Unearned premiums

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment/risk profile basis.

c. Acquisition costs
Acquisition costs, which represent commission and other related expenses, are deferred over the period in which the related premiums are earned.

d. Claims incurred
Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related loss adjustment expenses, together with any other adjustments to claims for previous years. Where applicable, deductions are made for salvage and other recoveries.

e. Claims provisions and related reinsurance recoveries
Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Company. The estimated cost of claims includes expenses to be incurred in settling claims and deduction for expected value of salvage and other recoveries. The Company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. Gross loss provisions are calculated gross of any reinsurance recoveries.

The estimate of claims incurred but not reported ('IBNR') is generally subject to a greater degree of uncertainty than the estimate of the cost of settling claims already notified to the Company, where more information about a claim event is generally available. Claims IBNR may not become known to the insurer until many years after the event giving rise to the claim. Classes of business where the IBNR proportion of the total reserve is high will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these reserves. Classes of business where claims are typically reported relatively quickly after the event tend to display lower levels of volatility. In calculating the estimated cost of unpaid claims the Company uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims including:

- changes in Company processes which might accelerate or slow down the development and/or recording of paid or incurred claims compared with the statistics from previous periods;
- changes in the legal environment;
- the effects of inflation;
- changes in the mix of business;
- the impact of large losses; and
- movements in industry benchmarks.

A component of these estimation techniques is usually the estimation of the cost of notified but not paid claims. In estimating the cost of these, the Company has regard to the claim circumstance as reported, any information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous periods.

Large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis and projected separately, in order to allow for the possible distortive effect of the development and incidence of these large claims.

Where possible, the Company adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The projections given by the various methodologies also assist in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each accident year.

Credit and Surety, London Market and Other Business
The majority of this business is 'short tail', that is, where claims are usually made during the term of the policy or shortly after the policy has expired. The cost of claims notified to the Company at the balance sheet date is estimated on a case-by-case basis to reflect the individual circumstances of each claim. The ultimate expected cost of claims is projected from this data by reference to statistics which show how estimates of claims incurred in previous years have developed over time to reflect changes in the underlying estimates of the cost of notified claims and late notifications.

Professional Risks
These claims are longer tail than those of the other classes of business described above and so a larger element of the claims provision relates to IBNR. Claims estimates for the Company's Professional

Indemnity business are derived from a combination of loss ratio based estimates and an estimate based upon actual claims experience. The initial estimate of the loss ratio is based on the experience of previous years, adjusted for factors such as premium rate changes, claims inflation and market environment. The estimate of claims inflation and anticipated market environment is particularly sensitive to the level of court awards and to the development of legal precedent on matters of contract.

Reinsurance

Reinsurance to cover catastrophe exposed lines or lines with unbalanced line size to premium is purchased on a shared basis for the international insurance entities. Reinsurance premiums on excess of loss programmes are allocated across the International platforms based on gross premiums written. Reinsurance recoveries are allocated based on the share of gross losses suffered by each carrier. Purchases of the shared reinsurance programme are advised to both Lloyd's and the PRA. Additionally, the Company purchases quota share reinsurance to balance line size and premium where it is prudent to do so.

The reinsurers' share of claims incurred in the profit and loss account reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the year. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the Profit and Loss Account as 'outwards reinsurance premiums'.

Unexpired risks provision

Provisions are made for any deficiencies arising when unearned premiums, net of associated acquisition costs, are insufficient to meet expected claims and expenses after taking into account future investment return on the investments supporting the unearned premiums provision and unexpired risks provision. The expected claims are calculated based on information available at the balance sheet date.

Unexpired risks surpluses and deficits are offset where business classes are managed together and a provision is made if an aggregate deficit arises. The unexpired risks provision would be included within 'Other technical provisions'.

Subrogation and salvage

Recoveries arising out of subrogation or salvage are estimated on a prudent basis and included within other debtors.

f. **Equalisation provision**

Under the Solvency I regime an equalisation provision was required to be held over and above a Company's technical provisions for certain classes of business. With the introduction of Solvency II there is no longer a requirement to hold the equalisation provision. In previous years, an amount was set aside as equalisation provision in accordance with the PRA's Handbook for the purpose of mitigating exceptionally high loss ratios in future years. With effect 1 January 2016 the equalisation provision balance was released to the General Technical Account.

g. **Exceptional items**

The Company classifies charges or credits which are unusual and material as exceptional items separately on the profit and loss account in order to provide further understanding of the financial performance of the Company.

h. **Taxation**

Current tax is provided at the current rate of corporation taxation on the results for the year as adjusted by items of income and expenditure which are disallowed for taxation purposes.

Deferred tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is calculated at the rates at which it is expected that the tax will arise. Deferred tax is recognised in the Profit and Loss Account for the period, except to the extent that it is attributable to a gain or loss that is recognised directly in the Statement of Comprehensive Income. Deferred tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax balances are not discounted.

i. **Business combinations**

Merger and Portfolio transfer

Effective 31 March 2015, the assets, liabilities and operations of Houston Casualty Company Europe, Seguros y Reaseguros, S.A. ('HCCE'), previously a wholly owned subsidiary of the Company, were merged with the Company ('the Merger'). The directors elected to account for the Merger as a portfolio transfer at the date of the Merger in accordance with FRS 103 (see Note 11).

j. **Intangible assets**

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment expense. Amortisation is calculated, using a straight-line method, to allocate the depreciable amount of the assets to their residual values over their estimated useful lives. Amortisation and any impairment expense are charged to other charges in the non-technical account. Intangible assets' residual values and useful lives are reviewed, and adjusted, if appropriate, at the end of each reporting period. The effect of any change is accounted for prospectively.

k. **Goodwill**

The Company's goodwill arose from the purchase of a book of Professional Indemnity business from another group Company in 2006 (see Note 15) and was capitalised at cost and is being amortised over its useful economic life on a straight line basis over 15 years (see Note 12). Each year the directors consider whether the carrying value of the goodwill has been impaired due to events or changes in circumstances which indicate that its value may not be recoverable.

l. **Land and buildings held as investments**

On an annual basis, the directors consider the open market valuation of the Company's land and buildings held as an investment. Should the valuation fall below its cost, the deficit is written off as impairment through the profit and loss account.

m. Tangible assets
Tangible assets are stated at cost, or open market valuation, less accumulated depreciation and accumulated impairment expense. Cost includes the original price, costs directly attributable to bringing the assets to its working condition for its intended use, dismantling and restoration costs.

Tangible assets are capitalised and depreciated on a straight line basis over their estimated useful lives as follows:

- Leasehold improvements 10%
- Computer equipment 33%
- Fixtures, fittings and office equipment 20%

n. Impairment of non-financial assets
At each balance sheet date non-financial assets not carried at fair value are assessed to determine whether there is an indication that the asset may be impaired. If so, the recoverable amount of the asset is compared to the carrying amount of the asset with an impairment loss recognised through the profit and loss account.

If an impairment loss is subsequently reversed, the carrying amount of the asset (or asset's cash generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the revised carrying amount does not exceed the carrying amount that would have been determined (net of depreciation or amortisation) had no impairment loss been recognised in prior periods. A reversal of an impairment loss is recognised in the profit and loss account.

o. Investments in subsidiary undertakings
Investments in subsidiary undertakings are stated in the balance sheet at fair value with changes in fair value recognised through the statement of comprehensive income, or, if an impairment expense, through the profit and loss account.

p. Cash and cash equivalents
Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts, when applicable, are shown within borrowings in current liabilities.

q. Provisions and contingencies
Provisions
Provisions are recognised when:

- the Company has a present legal or constructive obligation as a result of past events;
- it is probable that an outflow of resources will be required to settle the obligation; and
- the amount of the obligation can be estimated reliably.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations might be small. Provisions for levies are recognised on the occurrence of the event identified by legislation that triggers the obligation to pay the levy.

Contingencies
Contingent liabilities arise as a result of past events when:

(i) it is not probable that there will be an outflow of resources or that the amount cannot be reliably measured at the reporting date; or

(ii) when the existence will be confirmed by the occurrence or non-occurrence of uncertain future events not wholly within the Company's control.

Contingent liabilities are disclosed in the financial statements unless the probability of an outflow of resources is remote. Contingent assets are not recognised. Contingent assets are disclosed in the financial statements when an inflow of economic benefits is probable. Contingent assets stop being recognised as contingent at the point it is determined the benefit is virtually certain.

r. Financial instruments
The Company has adopted FRS 102 relating to fair value hierarchy disclosures and applied the recognition and measurement provisions of IAS 39 (as adopted for use in the EU) and the disclosure requirements of FRS 102 in respect of financial instruments.

s. Financial assets
The Company classifies its financial assets into the following categories:

- shares and other variable yield securities and units in unit trusts – at fair value through profit or loss;
- debt securities and other fixed-income securities – at fair value through profit or loss;
- equity securities – at fair value through profit or loss; and
- deposits with credit institutions – loans and receivables.

Management determines the classification of its investments at initial recognition and re-evaluates this at every reporting date.

Financial assets designated at fair value through profit and loss at inception are those that are managed and whose performance is evaluated on a fair value basis. Information about these financial assets is provided internally on a fair value basis to the Company's key management personnel. The Company's investment strategy is to invest in fixed and variable interest rate debt securities and units in unit trusts.

The fair values of financial instruments traded in active markets are based on quoted bid prices on the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency; and those prices represent actual and regularly occurring market transactions on an arm's length basis.

The fair values of financial instruments that are not traded in an active market (for example corporate bonds), are established by the directors using valuation techniques which seek to arrive at the price at which an orderly transaction would take place between market participants. Net gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are presented in the profit and loss account within 'unrealised gains on investments' or 'unrealised losses on investments' in the period in which they arise.

Deposits with credit institutions – loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Company intends to sell in the short term or that it has designated at fair value through profit or loss. When a financial liability is recognised initially it is measured at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial liability. Loans and receivables are subsequently measured at amortised cost using the effective interest rate method. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables. This basis of valuation is viewed by the directors as having prudent regard to the likely realisable value.

t. Impairment of financial assets
For financial assets not at fair value, the Company assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Company about the following events:

- significant financial difficulty of the issuer or debtor;
- a breach of contract such as a default or delinquency in payments;
- it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
    - adverse changes in the payment status of issuers or debtors in the group; or
    - national or local economic conditions that correlate with defaults on the assets in the Company.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, then it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred on loans and receivables, the amount of the loss is measured as the difference between the asset carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the profit and loss account for the period. As a practical expedient, the Company may measure impairment on the basis of an instrument's fair value using an observable market price.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Company's grading process that considers asset type, industry, geographical location, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated.

If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed through the profit and loss account for the period.

u. Financial liabilities
Creditors are financial liabilities and are recognised initially at fair value, net of directly attributable transaction costs. Long-term creditors are subsequently stated at amortised cost, using the effective interest method.

v. Investment return
Interest income is recognised using the effective interest rate method. Dividend income is recognised when the right to receive payment is established. Rental income and investment expenses are accounted for on an accruals basis.

Realised gains and losses on investments carried at fair value through profit and loss are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the fair value at the balance sheet date and their purchase price for their fair value at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the technical account for the earned investment income on investments supporting the insurance technical provisions and related shareholder's funds. This transfer is made so that the balance on the technical account is based on a longer-term rate of investment return and is not subject to distortion from short-term fluctuations in investment return.

w. Distributions to equity holders
Dividends and other distributions to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends and other distributions are approved by the shareholders and declared as payable. These amounts are recognised in the statement of changes in equity.

x. Share based payments
The Company has applied FRS 102 in its accounting for share options and restricted awards and units. See Note 12.

4. Critical accounting judgements and estimation uncertainty

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Significant judgements in applying the accounting policies
Estimation of the ultimate net losses incurred from the issuance of insurance contracts involves assumptions concerning the future, and the resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

i. The ultimate liability arising from claims made under insurance contracts
The estimate of the ultimate liability arising from claims made under insurance contracts is the Company's most critical accounting estimate. The carrying amount of the claims outstanding, net of reinsurance, is $430.6m (2015: $456.3m). There are many sources of uncertainty that need to be considered in the estimate of the liability that the Company will ultimately pay for such claims. The level of provision has been set on the basis of the information that is currently available, including potential outstanding loss advices, experience of development of similar claims, historical experience, case law and legislative and judicial actions.

The most significant assumptions made relate to the level of future claims, the level of future claims settlements and the legal interpretation of insurance policies. Whilst the directors consider that the gross provision for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them; the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amount provided. Adjustments to the amounts of provision are reflected in the financial statements for the period in which the adjustments are made. The methods used and the estimates made are reviewed regularly. See Note 5.1.iv for loss development triangles.

ii. Fair value of financial instruments
The fair value of financial instruments traded in active markets is based on quoted bid prices at the balance sheet date.

If quoted prices are unavailable, observable prices for recent arm's length transactions for an identical asset are used to determine its fair value. The carrying value of these instruments is $1,016.3m (2015: $987.5m), see Note 5.5 for pricing basis. The Company uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

iii. Estimated impairment of goodwill
In accordance with the accounting policy stated in Note 3 (k), goodwill is capitalised at cost and amortised over its useful economic life on a straight line basis over 15 years. On an annual basis the directors consider whether there are any events or changes in circumstances which indicate that the carrying value of goodwill may not be recoverable. Any decrease in its value would affect the Company's financial position.

iv. Pipeline premium
The Company makes an estimate of premiums written during the year that have not yet been notified by the financial year end ('pipeline premiums') based on prior year experience and current year business volumes. The pipeline premium is booked as written and an assessment is made of the related unearned premium provision and an estimate of claims incurred but not reported in respect of the earned element. The pipeline premium included within net written premium is $32.3m (2015: $35.4m).

5. Risk management

The Company has identified the risks arising from its activities and has established policies and procedures to manage these risks in accordance with its risk appetite. The Company maintains a risk register and categorises its risks into six areas: Insurance; Strategic, Regulatory and Group; Market; Operational Credit; and Liquidity. The sections below outline the Company's risk appetite and explain how it defines and manages each category of risk.

5.1 Insurance risk
The Company's insurance business assumes the risk of loss from persons or organisations that are themselves directly exposed to an underlying loss. Insurance risk arises from this risk transfer due to inherent uncertainties about the occurrence, amount and timing of insurance liabilities. The four key components of insurance risk are underwriting including delegated authorities, reinsurance purchasing, claims management and reserving. Each element is considered below.

i. Underwriting risk
Underwriting risk relates to the potential losses arising from inadequate underwriting. There are four elements that apply to all insurance products offered by the Company:

- cycle risk – the risk that business is written without full knowledge as to the (in) adequacy of rates, terms and conditions;
- event risk – the risk that individual risk losses or catastrophes lead to claims that are higher than anticipated in plans and pricing;

- pricing risk – the risk that the level of expected loss is understated in the pricing process; and
- expense risk – the risk that the allowance for expenses and inflation in pricing is inadequate.

The Company manages and models these four elements in the following three categories; attritional claims, large claims and catastrophe events.

The Company's underwriting strategy is to seek a diverse and balanced portfolio of risks in order to limit the variability of outcomes. This is achieved by accepting a spread of business over time, segmented between different products, geographies and sizes.

To manage underwriting exposures, the Company has developed limits of authority and business plans which are binding upon all staff authorised to underwrite and are specific to underwriters, classes of business and industry.

These authority limits are enforced through a comprehensive sign-off process for underwriting transactions including an escalation process for all risks exceeding individual underwriters' authority limits. Exception reports are also run regularly to monitor compliance and a rigorous peer and external review process are in place.

Rate monitoring, including risk adjusted rate change and adequacy against benchmark rates, are recorded and reported.

The annual corporate budgeting process comprises a three year Plan which incorporates the Company's underwriting strategy by line of business and sets out the classes of business, the territories and the industry sectors in which business is to be written. The Plan is approved by the directors and monitored by the underwriting committees on a monthly basis.

Underwriters calculate premiums for risks written based on a range of criteria tailored specifically to each individual risk. These factors include, but are not limited to, the financial exposure, loss history, risk characteristics, limits, deductibles, terms and conditions and acquisition expenses using rating and other models.

The Company also recognises that insurance events are, by their nature, random and the actual number and size of events during any one year may vary from those estimated using established statistical techniques.

To address this, the Company sets out its risk appetite (expressed as Probable Maximum Loss estimates ('PML') and modelled return period events) in certain territories as well as a range of events such as natural catastrophes and specific scenarios which may result in large industry losses. The aggregate position and modelled loss scenarios are monitored at the time of underwriting a risk and reports are regularly produced to highlight the key aggregations to which the Company is exposed.

The Company uses a number of modelling tools to monitor its exposures against the agreed risk appetite set and to simulate catastrophe losses in order to measure the effectiveness of its reinsurance programmes. Stress and scenario tests are also run using these models.

One of the largest types of event exposure relates to natural catastrophe events such as windstorm or earthquake. Where possible, the Company measures geographic accumulations and uses its knowledge of the business, historical loss behaviour and commercial catastrophe modelling software to assess the expected range of losses at different return periods. Upon application of the reinsurance coverage purchased, the key gross and net exposures are calculated on the basis of extreme events at a range of return periods.

The Company's catastrophe risk appetite set by the directors is limited to a gross PML aggregate of no more than 200% of Capital and for a probability of gross catastrophe event exceeding 50% of Capital of less than 1%. Additionally, the appetite for non-modelled risk and other potential non-Natural Catastrophe perils is in line with the Catastrophe appetites noted above.

ii. Reinsurance risk

Reinsurance risk arises where reinsurance contracts:

- do not perform as anticipated;
- result in coverage disputes; or
- prove inadequate in terms of the vertical or horizontal limits purchased.

Failure of a reinsurer to pay a valid claim is considered a credit risk which is detailed in the credit risk section. See Note 5.5.

The purchase of reinsurance is a key tool utilised to manage underwriting risk. The Company's reinsurance programme is comprised predominantly of excess of loss cover which may be over placed to protect against reinstatement costs. Prior to placement of the programme, it is modelled against significant historic and modelled events across the peak exposure areas. The programme is purchased on a class of business basis, modelling catastrophe, large and attritional losses separately.

Consideration is given to a number of factors when setting minimum retention including the Annual Aggregate Loss ('AAL') for catastrophe exposed lines. Where market opportunity allows, additional reinsurance is purchased. Quota share and facultative reinsurance is also utilised where considered appropriate. A TMHCC reinsurance approval group examines and approves all reinsurers to ensure that they possess suitable security. The Company's reinsurance team ensures that these guidelines are followed, undertakes the administration of reinsurance contracts and monitors and instigates the Company's responses to any erosion of the reinsurance programmes.

iii. Claims management risk

Claims management risk may arise within the Company in the event of inaccurate or incomplete case reserves and claims settlements, poor service quality or excessive claims handling costs. These risks may damage the Company brand and undermine its ability to win and retain business, or incur punitive damages. These risks can occur at any stage of the claim life cycle.

The Company's claims teams are focused on delivering quality, reliability and speed of service to both internal and external clients. Their aim is to adjust and process claims in a fair, efficient and timely manner, in accordance with the policy's terms and conditions, the regulatory environment and the business's broader interests. Prompt and accurate case reserves are set for all known claims liabilities, including provisions for expenses, as soon as a reliable estimate can be made of the claims liability.

iv. Reserving risk

Reserving risk occurs within the Company where established insurance liabilities are insufficient through inaccurate forecasting, or where there is inadequate allowance for expenses and reinsurance bad debts.

The objective of the Company's reserving policy is to produce accurate and reliable estimates that are consistent over time and across classes of business. The Company's reserving process is governed by the IBNR Committee, a subcommittee of the Board, which meets on a quarterly basis (more frequently if catastrophic events require). The membership of the IBNR Committee is comprised of executives, actuarial, claims and finance representatives. A fundamental part of the reserving process involves information from and recommendations by each underwriting team for each underwriting year and reserving class of business. These estimates are compared to the actuarial estimates (described in further detail below) and management's best estimate of IBNR is recorded. It is the policy of the Company to carry, at a minimum, the actuarial best estimate. It is not unusual for management's best estimate to be higher than the actuarial best estimate.

The actuarial reserving team uses a range of recognised techniques to project current paid and incurred claims and monitors claim development patterns. This analysis is then supplemented by a variety of tools including back testing, scenario testing, sensitivity testing and stress testing.

Gross and net development triangles of the estimate of ultimate claim cost for claims notified in a given year are presented below and give an indication of the accuracy of the Company's estimation technique for claims payments. Data has been translated using 31 December 2016 foreign exchange rates throughout the triangle.

	Accident year						
Loss development triangles – GROSS Ultimate claims and cumulative payments	**2011 $'000**	**2012 $'000**	**2013 $'000**	**2014 $'000**	**2015 $'000**	**2014 $'000**	**Total $'000**
End of reporting year	243,029	150,170	184,373	158,396	443,343	254,217	
– one year later	247,930	119,364	197,946	162,142	513,276		
– two years later	235,003	128,783	195,698	136,696			
– three years later	230,291	130,533	177,300				
– four years later	210,602	141,710					
– five years later	206,034						
Current estimate of ultimate claims	206,034	141,710	177,300	136,696	513,276	254,217	
Cumulative payments to date	(176,072)	(96,766)	(124,386)	(66,806)	(225,070)	(64,937)	
Liability recognised in the balance sheet	29,962	44,944	52,914	69,890	288,206	189,280	675,196
Provision in respect of previous years							37,118
Total provision included in the balance sheet							712,314

	Accident year						
Loss development triangles – NET Ultimate claims and cumulative payments	**2011 $'000**	**2012 $'000**	**2013 $'000**	**2014 $'000**	**2015* $'000**	**2014 $'000**	**Total $'000**
End of reporting year	126,852	116,449	157,760	120,484	242,579	185,120	
– one year later	127,950	115,644	155,085	121,459	254,131		
– two years later	116,748	103,472	144,853	101,608			
– three years later	117,508	99,176	138,610				
– four years later	112,666	95,958					
– five years later							
Current estimate of ultimate claims	110,496	95,958	138,610	101,608	254,131	185,120	
Cumulative payments to date	(91,973)	(76,763)	(96,169)	(57,523)	(97,112)	(58,948)	
Liability recognised in the balance sheet	18,523	19,195	42,441	44,085	157,019	126,172	407,435
Provision in respect of previous years							23,204
Total provision included in the balance sheet							430,639

*The increase in the 2015 accident year reserves is due to the Merger, effective 1 April 2015. See Note 11.

5.2 Strategic, regulatory and group risk

The Company manages strategic, regulatory and group risks together. Each element is considered below:

i. Strategic risk

This is the risk that the Company's strategy is inappropriate or that the Company is unable to implement its strategy. Where an event exceeds the Company's strategic plan, this is escalated at the earliest opportunity through the Company's monitoring tools and governance structure.

On a day-to-day basis, the Company's management structure encourages organisational flexibility and adaptability, while ensuring that activities are appropriately coordinated and controlled. By focusing on the needs of their customers and demonstrating both progressive and responsive abilities, staff, management and outsourced service providers are expected to excel in service and quality. Individuals and teams are also expected to transact their activities in an open and transparent way. These behavioural expectations reaffirm low risk tolerance by aligning interests to ensure that routine activities, projects and other initiatives are implemented to benefit and protect resources of both local business segments and the Company as a whole.

ii. Regulatory risk

Regulatory risk is the risk arising from not complying with regulatory and legal requirements. The operations of the Company are subject to legal and regulatory requirements within the jurisdictions in which it operates and the Company's compliance function is responsible for ensuring that these requirements are adhered to. Regulatory risk includes capital management risk.

The Company estimates its Economic capital requirements using an internal model (the Economic Capital Model ('ECM')) which, the Directors believe, is the most appropriate tool to determine the Company's medium term capital needs. However, the Company is currently outside of the PRA Internal Model Approval Process ('IMAP') and since 1 January 2016 has measured regulated capital requirement using the Standard Formula Solvency Capital Requirement ('SF SCR'). The Board has reviewed the SF SCR against the ECM and has concluded that the SF SCR is appropriate. The SF SCR is measured against the Company's Solvency II Available Assets to monitor its Solvency. Given the inherent volatility of the SF SCR and Solvency II Available Assets, the Company carries an amount in excess of the regulatory minimum. At 31 December 2016, the estimated Solvency II Available Assets were 190% in excess of the regulatory minimum.

iii. Group risk

Group risk occurs where business units fail to consider the impact of other parts of a group on the Company, as well as the risks arising from these activities. There are two main components of group risk which are explained below.

a. Contagion

Contagion risk is the risk arising from actions of one part of a group which could adversely affect any other part of the group. The Company is a member of the Tokio Marine group and therefore may be impacted by the actions of any other group Company. This risk is managed by operating with clear and open lines of communication across the group to ensure all group entities are well informed and working to common goals.

b. Reputation

Reputation risk is the risk of negative publicity as a result of the Tokio Marine group's contractual arrangements, customers, products, services and other activities. The Company's preference is to minimise reputation risks, but it is not possible or beneficial to avoid them, as the benefits of being part of the group brand are significant.

The Company considers reputation risk as an impact on all risk events in the Risk Register, but not as a risk in its own right.

5.3 Market risk

Market risk arises where the value of assets and liabilities or future cash flows change as a result of fluctuations in economic variables, such as movements in foreign exchange rates, interest rates and market prices.

Managing investment risk as a whole is fundamental to the operation and development of the Company's investment strategy key to the investment of Company assets.

The investment strategy is developed by reference to an investment risk budget, set annually by the directors as part of the overall risk budgeting framework of the business. In 2016, the investment risk budget was set at a level such that the amount of an investment loss, at the 1-in-200 Tail Value at Risk (TVaR) level, was limited to the Company's excess capital (above the regulatory minimum). This was the result of a complete investment strategy review carried out by the Company's Investment Managers, New England Asset Management Ltd. The investment risk budget will be at a similar level in 2017.

Investment strategy is consistent with this risk appetite and investment risk is monitored on an ongoing basis. The internal model includes an asset risk module, which uses an Economic Scenario Generator ('ESG') to simulate multiple simulations of financial conditions, to support stochastic analysis of investment risk. This is supplemented by bespoke analysis from the Company's investment consultants. Internal model output is used to assess potential investment downsides, at different confidence levels, including '1 in 200' year event, which reflects Solvency II modelling requirements. In addition, the Company undertakes regular scenario tests (which look at shock events such as yield curve shifts, credit spread widening, or the repeat of historic events) to assess the impact of potential investment losses.

ESG outputs are regularly validated against actual market conditions, but (as noted above) the Company also uses a number of other qualitative measures to support the monitoring and management of investment risk.

i. Foreign exchange risk

The Company's functional and reporting currency is the US Dollar and when possible the Company generally hedges currency liabilities with assets in those same currencies. Excess assets are generally held in US Dollars. The effect of this on foreign exchange risk is that the Company is mainly exposed to revaluation FX gains/losses of unmatched non-US Dollar denominated positions.

The Company operates in five main currencies: US Dollars; Sterling; Canadian Dollars; Swiss Francs; and Euros. Transactions in all currencies are converted to the

US Dollar functional currency on initial recognition with any balances on monetary items at the reporting date being translated at the US Dollar spot rate.

The following table summarises the carrying value of total assets and total liabilities and net profit, converted to US Dollars, categorised by the Company's main currencies:

FX risk exposure 31 December 2016	AUD $ $'000	CAD $ $'000	CHF Fr $'000	EUR € $'000	GBP £ $'000	Subtotal $'000	USD $ $'000	Total $'000
Total assets	23,206	2,793	27,244	330,100	328,445	711,788	1,122,888	1,834,676
Total liabilities	(28,145)	(1,238)	(17,476)	(371,854)	(402,374)	(821,087)	(386,618)	(1,207,705)
Net assets	**(4,939)**	**1,555**	**9,768**	**(41,754)**	**(73,929)**	**(109,299)**	**736,270**	**626,971**
Net profit	**212**	**961**	**(6,324)**	**(12,780)**	**9,620**	**(8,311)**	**(129,787)**	**(138,098)**

FX risk exposure 31 December 2015	AUD $ $'000	CAD $ $'000	CHF Fr $'000	EUR € $'000	GBP £ $'000	Subtotal $'000	USD $ $'000	Total $'000
Total assets	19,973	2,564	19,956	380,944	421,842	845,279	955,003	1,800,282
Total liabilities	(24,699)	(48)	(16,512)	(435,470)	(468,812)	(945,541)	(375,367)	(1,320,908)
Net assets	**(4,726)**	**2,516**	**3,444**	**(54,526)**	**(46,970)**	**(100,262)**	**579,636**	**479,374**
Net profit	**(4,576)**	**2,259**	**(1,411)**	**3,156**	**16,777**	**16,205**	**25,023**	**41,228**

Sensitivity analysis
Fluctuations in the Company's operating currencies against US Dollars would result in a change to net profit and net asset value. The table below gives an indication of the impact on net profit and net assets of a percentage change in the relative strength of the US Dollar against the value of the Australian Dollar, Canadian Dollar, Swiss Franc, the Euro, and Sterling, simultaneously.

FX risk exposure – sensitivity	Impact on profit after tax		Impact on net assets	
Change in exchange rate of Canadian Dollar, Australian Dollar, Euro and Sterling, relative to US Dollar	**2016 $'000**	**2015 $'000**	**2016 $'000**	**2015 $'000**
US Dollar weakens 30% against other currencies	(1,995)	664	(32,789)	(30,079)
US Dollar weakens 20% against other currencies	(1,330)	443	(21,860)	(20,053)
US Dollar weakens 10% against other currencies	(665)	221	(10,930)	(10,026)
US Dollar strengthens 10% against other currencies	665	(221)	10,930	10,026
US Dollar strengthens 20% against other currencies	1,330	(443)	21,860	20,053
US Dollar strengthens 30% against other currencies	1,995	(664)	32,789	30,079

ii. Interest rate risk

Some of the Company's financial instruments, including cash and certain financial assets at fair value, are exposed to movements in market interest rates.

The Company manages interest rate risk by investing primarily in short duration financial assets along with cash. The Investment Committee monitors the duration of these assets on a regular basis.

Changes in interest rates also impact the present values of estimated Company liabilities, which are used for solvency calculations. The Company's investment strategy reflects the nature of the Company's liabilities, and the combined market risk of investment assets and estimated liabilities is monitored and managed within specified limits.

The following table shows the average duration at the reporting date of the financial instruments that are exposed to movements in market interest rates. Duration is a commonly used measure of volatility and the Company believes this gives a better indication than maturity of the likely sensitivity of the Company's investment portfolio to changes in interest rates.

Investments and cash – duration 31 December 2016	<1 yr $'000	1-2 yrs $'000	2-3 yrs $'000	3-4 yrs $'000	4-5 yrs $'000	5-10 yrs $'000	>10 yrs $'000	Total
Variable yield securities	32,520	–	–	–	–	–	–	32,520
Debt securities	175,300	125,177	119,215	195,243	127,223	74,481	184,034	1,000,673
Equity securities	77,005	–	–	–	–	–	–	77,005
Total other financial investments	**284,825**	**125,177**	**119,215**	**195,243**	**127,223**	**74,481**	**184,034**	**1,110,198**
Deposits from third parties	57,812	–	–	–	–	–	–	57,812
Cash at bank	61,941	–	–	–	–	–	–	61,941
Total	**404,578**	**125,177**	**119,215**	**195,243**	**127,223**	**74,481**	**184,034**	**1,229,951**

Investments and cash – duration 31 December 2015	<1 yr $'000	1-2 yrs $'000	2-3 yrs $'000	3-4 yrs $'000	4-5 yrs $'000	5-10 yrs $'000	>10 yrs $'000	Total
Variable yield securities	19,544	–	–	–	–	–	–	19,544
Debt securities	123,212	153,332	143,915	198,061	134,014	64,289	156,058	972,881
Equity securities	70,470	–	–	–	–	–	–	70,470
Total other financial investments	**213,226**	**153,332**	**143,915**	**198,061**	**134,014**	**64,289**	**156,058**	**1,062,895**
Deposits from third parties	48,011	–	–	–	–	–	–	48,011
Cash at bank	36,350	–	–	–	–	–	–	36,350
Total	**297,587**	**153,332**	**143,915**	**198,061**	**134,014**	**64,289**	**156,058**	**1,147,256**

Sensitivity analysis
Changes in interest yields, with all other variables constant, would result in changes in the market value of debt securities as well as subsequent interest receipts and payments. This would affect reported profits after tax and net assets as indicated in the table below:

Investments and cash – interest rate sensitivity	Impact on profit after tax		Impact on net assets	
Shift in yield (basis points)	**2016 $'000**	**2015 $'000**	**2016 $'000**	**2015 $'000**
100 basis point increase	(29,833)	(27,612)	(29,833)	(27,612)
50 basis point increase	(14,916)	(13,806)	(14,916)	(13,806)
50 basis point decrease	14,758	11,875	14,758	11,875
100 basis point decrease	29,517	23,750	29,517	23,750

5.4 Operational risk
Operational risk arises from the risk of losses due to inadequate or failed internal processes, people, systems, service providers or external events. Operational risk includes conduct risk.

The Company actively manages and minimises operational risks where appropriate. This is achieved by implementing and communicating guidelines and detailed procedures and controls to staff and other third parties. The Company regularly monitors the performance of its controls and adherence to procedures through the risk management reporting process. Key components of the Company's operational control environment include:

- modelling of operational risk exposure and scenario testing;
- management review of activities;
- documentation of policies and procedures;
- preventative and detective controls within key processes;
- contingency planning; and
- other systems controls.

Addressing conduct risk has always been treated as a priority irrespective of the regulatory emphasis on the selling of financial products, including insurance products, to consumers. The Company's primary objective is that all policyholders should receive fair treatment throughout the product lifecycle, which requires the effective management of conduct risk. However, conduct risk is not limited to the fair treatment of customers and the Company's Conduct Risk Policy broadly defines conduct risk as "…the risk that detriment is caused to the Company, our customers, clients or counterparties because of the inappropriate execution of our business activities".

The Company therefore seeks at all times to perform its business activities in a manner that is not only fair, honest and transparent but that also complies fully with applicable UK and International laws and regulations and internal policies and procedures. The Company ensures that this ethos is clearly communicated from the Board of directors downwards to all members of staff and oversight is provided throughout the governance structure, primarily by way of the Product Governance and Distribution Committee. Day-to-day responsibility for monitoring the fair treatment of customers and broader aspects of conduct risk resides with the International Compliance Department which undertakes scheduled reviews as part of a comprehensive Compliance Monitoring schedule.

5.5 Credit risk
Credit risk arises where counterparties fail to meet their financial obligations in full as they fall due. The primary sources of credit risk for the Company are:

- reinsurers – whereby reinsurers may fail to pay valid claims against a reinsurance contract held by the Company;
- brokers and coverholders – whereby counterparties fail to pass on premiums or claims collected or paid on behalf of the Company;
- investments – whereby issuer default results in the Company losing all or part of the value of a financial instrument; and
- financial institutions holding cash.

The Company's core business is to accept insurance risk and the appetite for other risks is low. This protects the Company's solvency from erosion from non-insurance risks so that it can meet its insurance liabilities.

The Company limits exposure to a single counterparty or a group of counterparties and analyses the geographical locations of exposures when assessing credit risk.

An approval system exists for all new brokers and coverholders and their performance is carefully monitored. Regular exception reports highlight trading with non-approved brokers, and the Company's credit control function frequently assesses the ageing and collectability of debtor balances. Any large aged items are prioritised and where collection is outsourced incentives are in place to support these priorities.

The Investment Committee has established comprehensive guidelines for the Company's Investment Managers regarding the type, duration and quality of investments acceptable to the Company to ensure credit risk relating to the investment portfolio is kept to a minimum. The performance of the Company's Investment Managers is regularly reviewed to confirm adherence to these guidelines.

The Company has developed processes to formally examine all reinsurers before entering into new business arrangements. New reinsurers are approved by the reinsurance approval group, which also reviews arrangements with all existing reinsurers at least annually. Vulnerable or slow-paying reinsurers are examined more frequently. To assist in the understanding of credit risks, A.M. Best, Moody's and Standard & Poor's ('S&P') ratings are used. The Company's concentrations of credit risk have been categorised by these ratings as follows:

Investments and cash – credit ratings 31 December 2016	AAA $'000	AA $'000	A $'000	BBB $'000	BB $'000	Total $'000
Variable yield securities	32,520	–	–	–	–	32,520
Debt securities	118,783	479,625	275,769	115,563	10,933	1,000,673
Equity securities	77,005	–	–	–	–	77,005
Total other financial investments	**228,308**	**479,625**	**275,769**	**115,563**	**10,933**	**1,110,198**
Cash at bank	61,941	–	–	–	–	61,941
Total	**290,249**	**479,625**	**275,769**	**115,563**	**10,933**	**1,172,139**

Investments and cash – credit ratings 31 December 2015	AAA $'000	AA $'000	A $'000	BBB $'000	BB $'000	Total $'000
Variable yield securities	19,544	–	–	–	–	19,544
Debt securities	124,580	422,138	306,117	119,033	1,013	972,881
Equity securities	70,470	–	–	–	–	70,470
Total other financial investments	**214,594**	**422,138**	**306,117**	**119,033**	**1,013**	**1,062,895**
Cash at bank	5	–	6,946	29,054	345	36,350
Total	**214,599**	**422,138**	**313,063**	**148,087**	**1,358**	**1,099,245**

The Company's largest counterparty exposure is $176.5 of US Government securities (2015: $178.7m).

Insurance receivables and other receivable balances held by the Company have not been impaired based on available evidence and no impairment provision has been recognised in respect of these assets. An aged analysis of the Company's insurance and reinsurance receivables that are past due at the reporting date is presented below:

Financial assets – ageing 31 December 2016	Not yet due $'000	Up to 3 months past due $'000	3 to 6 months past due $'000	7 to 12 months past due $'000	> 1 year past due $'000	Total $'000
Reinsurers share of claims outstanding	281,675	–	–	–	–	281,675
Insurance debtors	82,145	8,976	4,834	2,403	–	98,358
Reinsurance debtors	19,122	2,189	1,179	585	–	23,075
Other debtors	50,294	–	–	–	–	50,294
Total	**433,236**	**11,165**	**6,013**	**2,988**	–	**453,402**

Financial assets – ageing 31 December 2015	Not yet due $'000	Up to 3 months past due $'000	3 to 6 months past due $'000	7 to 12 months past due $'000	> 1 year past due $'000	Total $'000
Reinsurers share of claims outstanding	293,688	–	–	–	–	293,688
Insurance debtors	73,713	7,157	2,288	3,322	–	86,480
Reinsurance debtors	35,299	3,427	1,095	1,591	–	41,412
Other debtors	61,170	–	–	–	–	61,170
Total	**463,870**	**10,584**	**3,383**	**4,913**	–	**482,750**

Fair value estimation

The following table presents the Company's financial investments measured at fair value at 31 December 2016 and 31 December 2015 categorised into levels 1, 2 and 3, reflecting the categorisation criteria specified in FRED 62. No liabilities were measured at fair value at 31 December 2016 or 31 December 2015.

Financial investments – pricing basis 31 December 2016	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Variable yield securities	–	32,520	–	32,520
Debt securities	16,858	983,815	–	1,000,673
Equity securities	77,005	–	–	77,005
Total other financial investments	**93,863**	**1,016,335**	–	**1,110,198**

Financial investments – pricing basis 31 December 2015	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Variable yield securities	–	19,544	–	19,544
Debt securities	4,956	967,925	–	972,881
Equity securities	70,470	–	–	70,470
Total other financial investments	**75,426**	**987,469**	–	**1,062,895**

FRED 62 defines the disclosure of investment levels as follows:

- Level 1 – inputs are based on quoted prices in active markets for identical instruments;

The Company's Level 1 investments consist of U.S. Treasuries, money market funds and equity securities traded in an active exchange market. The Company uses unadjusted quoted prices for identical instruments to measure fair value.

- Level 2 – inputs are based on observable market data (other than quoted prices) or are derived from or corroborated by observable market data;

The Company's Level 2 investments include most of its fixed maturity securities, which consist of U.S. government agency securities, foreign government securities, municipal bonds (including those held as restricted securities), corporate debt securities, bank loans, middle market senior loans, foreign debt securities, mortgage-backed and asset-backed securities (including collateralized loan obligations). The Company measures fair value for the majority of its Level 2 investments using matrix pricing and observable market data, including benchmark securities or yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, bids, offers, default rates, loss severity and other economic measures. The Company measures fair value for its structured securities using observable market data in cash flow models.

The Company is responsible for the prices used in its fair value measurements. The Company uses independent pricing services to assist itself in determining fair value of all of its Level 2 investments. The pricing services provide a single price or quote per security. The Company uses data provided by the Company's third party investment managers to value the remaining Level 2 investments. To validate that these quoted prices are reasonable estimates of fair value, the Company performs various quantitative and qualitative procedures, including:

1) evaluation of the underlying methodologies;

2) analysis of recent sales activity;

3) analytical review of the Company's fair values against current market prices; and

4) comparison of the pricing services' fair value to other pricing services' fair value for the same investment.

No markets for the Company's investments were judged to be inactive at period end. Based on these procedures, the Company did not adjust the prices or quotes provided by its independent pricing services, third party investment managers as of 31 December 2016 or 31 December 2015.

- Level 3 – Inputs are unobservable and not corroborated by market data.

The Company has no Level 3 securities.

5.6 Liquidity risk

Liquidity risk arises where cash may not be available to pay obligations when due at a reasonable cost. The Company is exposed to daily calls on its available cash resources, principally from claims arising from its insurance business. In the majority of cases, these claims are settled from premiums received.

The Company's approach is to manage its liquidity position so that it can reasonably survive a significant individual or market loss event (details of the Company's management of its exposure to loss scenarios are provided in Note 5.1.i). This means that the Company maintains sufficient liquid assets, or assets that can be readily converted into liquid assets at short notice, to meet expected cash flow requirements. These liquid funds are regularly monitored using cash flow forecasting to ensure that surplus funds are invested to achieve a higher rate of return. The Company can also draw on group funds to bridge short-term cash flow requirements. The following table is an analysis of the net contractual cash flows based on all the liabilities held at 31 December 2016 and 2015:

Financial liabilities – projected cash flows 31 December 2016	Within 1yr $'000	1-3 years $'000	3-5 years $'000	>5 years $'000	Total $'000
Net claims outstanding	132,009	152,804	72,383	73,443	430,639
Creditors from direct insurance operations	12,696	–	–	–	12,696
Creditors from reinsurance operations	51,447	–	–	–	51,447
Other creditors	48,250	–	–	–	48,250
Total	**244,402**	**152,804**	**72,383**	**73,443**	**543,032**

Financial liabilities – projected cash flows 31 December 2015	Within 1yr $'000	1-3 years $'000	3-5 years $'000	>5 years $'000	Total $'000
Net claims outstanding	130,984	169,614	76,923	78,820	456,341
Creditors from direct insurance operations	12,624	–	–	–	12,624
Creditors from reinsurance operations	58,294	–	–	–	58,294
Other creditors	27,030	–	–	–	27,030
Total	**228,932**	**169,614**	**76,923**	**78,820**	**554,289**

The next two tables summarise the carrying amount at the reporting date of financial instruments analysed by maturity date

Investments and cash – maturity 31 December 2016	Within 1yr $'000	1-3 years $'000	3-5 years $'000	>5 years $'000	Total $'000
Variable yield securities	32,520	–	–	–	32,520
Debt securities	126,683	204,693	137,145	532,152	1,000,673
Equity securities	77,005	–	–	–	77,005
Total other financial investments	**126,208**	**204,693**	**137,145**	**532,152**	**1,110,198**
Cash at bank	61,941	–	–	–	61,941
Total	**298,149**	**204,693**	**137,145**	**532,152**	**1,172,139**

Investments and cash – maturity 31 December 2015	Within 1yr $'000	1-3 years $'000	3-5 years $'000	>5 years $'000	Total $'000
Variable yield securities	19,544	–	–	–	19,544
Debt securities	68,769	221,369	158,715	524,028	972,881
Equity securities	70,470	–	–	–	70,470
Total other financial investments	158,783	221,369	158,715	524,028	1,062,895
Cash at bank	36,350	–	–	–	36,350
Total	**195,133**	**221,369**	**158,715**	**524,028**	**1,099,245**

6. Segmental information

(a) Underwriting result by class of business

2016	Gross premiums written $'000	Gross premiums earned $'000	Gross claims incurred $'000	Gross operating expenses $'000	Reinsurance balance $'000	Net underwriting result $'000
Direct insurance						
Accident and health	13,104	12,583	4,283	5,760	(3,356)	(816)
Credit, political risk and suretyship	147,199	145,052	101,431	55,546	22,212	10,287
Travel	58,810	54,701	31,290	30,036	(103)	(6,728)
Marine, aviation and transport	22,759	22,862	33,791	8,384	30,762	11,449
Miscellaneous	9,220	8,072	(3,138)	4,070	(12,365)	(5,225)
Third party liability	204,048	204,389	87,130	84,894	(11,492)	20,873
Total direct	455,140	447,659	254,787	188,690	25,658	29,840
Reinsurance acceptances	93,490	103,074	40,195	32,115	(5,996)	24,768
Total	548,630	550,733	294,982	220,805	19,662	54,608
Investment return						24,157
Equalisation provision						96,225
Technical account						174,990

2015 Restated	Gross premiums written $'000	Gross premiums earned $'000	Gross claims incurred $'000	Gross operating expenses $'000	Reinsurance balance $'000	Net underwriting result $'000
Direct insurance						
Accident and health	11,632	13,135	7,405	5,893	(1,361)	(1,524)
Credit, political risk and suretyship	152,281	140,180	80,937	57,085	26,323	28,481
Travel	11,926	10,353	3,942	7,035	(63)	(687)
Marine, aviation and transport	25,819	29,564	23,298	8,882	(1,818)	(4,434)
Miscellaneous	8,062	7,812	(8,206)	3,687	(11,994)	337
Third party liability	208,321	187,857	79,096	71,864	(8,569)	28,328
Total direct	418,041	388,901	186,472	154,446	2,518	50,501
Reinsurance acceptances	118,353	126,726	32,978	39,246	(9,060)	45,442
Total	536,394	515,627	219,450	193,692	(6,542)	95,943
Investment return						22,434
Equalisation provision						(16,057)
Technical account						102,320

The reinsurance balance represents the (charge)/credit to the technical account from the aggregate of all items relating to reinsurance outwards.

The 2015 Underwriting result by class of business was restated to present separately Travel class of business previously included as part of Miscellaneous.

(b) Geographical location of underwriting operations

	Gross premiums written		Profit before taxation and exceptional items		Net assets	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000	2016 $'000	2015 $'000
United Kingdom	421,916	404,265	176,995	48,637	615,431	469,095
Rest of Europe	126,714	132,129	(34)	19,158	11,540	10,279
	548,630	536,394	176,961	67,795	626,971	479,374

(c) Geographical location of gross premiums written by destination

	2016 $'000	2015 $'000
United Kingdom	286,791	269,747
Rest of Europe	159,310	173,400
Rest of the World	102,529	93,247
	548,630	536,394

7. Investment return

	2016 $'000	Restated 2015 $'000
Investment income:		
Income from other financial investments at fair value through profit or loss	24,269	22,295
Bank interest receivable and similar income	(30)	(1)
Investment property rental income	8	18
Distributions from group undertakings	–	32
Gains on the realisation of financial investments at fair value through profit or loss excluding FX from revaluation	3,631	2,355
	27,878	24,699
Investment expenses and charges:		
Investment management fees and charges	(1,692)	(1,480)
Losses on the realisation of financial investments at fair value through profit or loss excluding FX from revaluation	(2,051)	(737)
	(3,743)	(2,217)
Net unrealised gains (losses) on investments:		
Unrealised gains on financial investments at fair value through profit or loss excluding FX from revaluation	8,659	3,523
Unrealised losses on financial investments at fair value through profit or loss excluding FX from revaluation	(2,237)	(16,555)
	6,422	(13,032)
Total investment return	30,557	9,450

	2016 $'000	Restated 2015 $'000
Allocation of investment return:		
Earned investment income allocated to the general business technical account	24,157	22,434
Investment return allocated to the non-technical account	6,400	(12,984)
Total Investment return	30,557	9,450

The Company recorded $25.1m foreign exchange losses in revaluation of the non-US Dollar investment portfolio (2015: $15.9m losses). Additionally foreign exchange gains on revaluation of other non-USD Dollar monetary assets and liabilities totalled $30.2.m (2015: $13.3m gains).

2015 Investment return was restated to reflect reclassification of foreign exchange losses on investments separately in Profit and Loss account.

8. Net operating expenses

	2016 $'000	2015 $'000
Commission costs	136,165	120,563
Reinsurance commissions and profit participation	(18,357)	(23,573)
Change in deferred acquisition costs	(132)	(8,866)
Deferred acquisition costs	117,676	88,124
Administrative expenses	84,772	81,994
	202,448	170,118

Total commission written during the year in respect of direct insurance was $99.4m (2015: $101.2m).

Deferred acquisition costs reconciliation	2016 $'000	2015 $'000
At 1 January	74,394	65,305
Expenses for the acquisition of insurance deferred during the year	117,808	96,990
Amortisation	(117,676)	(88,124)
Foreign exchange losses	(1,378)	223
At 31 December	73,148	74,394

9. Staff costs

All staff are employed by HCC Service Company Inc. (UK branch). The disclosures for staff costs below relate to underwriting and other direct staff only. The costs of staff providing central services for group entities are allocated and recharged to the Company as a management fee. These staff are not included in salary costs and average staff numbers as it is not practical to allocate them to the underlying entities to which the staff provides services.

	2016 $'000	2015 $'000
Wages and salaries	25,332	22,020
Social security costs	2,936	3,952
Other pension costs	1,419	1,271
	29,687	27,243

The average numbers of direct staff (excluding directors) working for the Company during the year were as follows:

	2016 Number	2015 Number
Underwriting	115	110
Claims	9	15
Administration and finance	29	29
	153	154

Directors' emoluments
The compensation of executive directors attributable to the Company is charged as a management fee and not included in staff costs.

	2016 $'000	2015 $'000
Aggregate emoluments (excluding share options and awards)	4,478	4,506
Pension contributions	45	157
	4,523	4,663

Pension benefits are accruing to four directors (2015: five) under the Group's defined contribution pension scheme. In 2015, principally as a result of the TMHD Acquisition, five directors received cash totalling $8.7m from the accelerated vesting of restricted awards and share options, some of which had been expensed in previous years (see Note 12).

	2016 $'000	2015 $'000
Aggregate emoluments (excluding share options and awards)	1,631	1,316
Pension contributions	–	–
	1,631	1,316

Share options and restricted awards and units vested at the date of the TMHD acquisition as the plan was closed. In 2015, the highest paid director received $3.7m from share options.

10. Auditors' remuneration

During the year the Company and its subsidiary undertakings obtained the following services from the Company's auditors at costs as detailed below:

	2016 $'000	2015 $'000
Audit of the Company's financial statements	527	479
Audit of the Company's subsidiary undertakings' financial statements	–	–
Audit-related assurance services	186	77
Tax compliance services	19	30
Tax advisory services	7	142
	739	728

11. Business combination

Effective 1 April 2015, the assets, liabilities and operations of the Company's subsidiary Company, Houston Casualty Company Europe, Seguros y Reaseguros S.A. (HCCE), were merged into the Company's operations and HCCE was dissolved. The transfer of the technical balances was accounted for as a portfolio transfer. No gain/loss arose at the date of merger. At the Merger date, HCCE net asset value totalled $20.4m comprising $278.3m assets and $257.9m liabilities and included the following items:

Balances transferred to HCCII	1 April 2015 $'000
Other financial investments	79,553
Debtors arising out of reinsurance operations	43,421
Reinsurers' share of claims outstanding	112,772
Claims outstanding	231,577
Provision for unearned premiums	5,346

Gross premium written of $5.6m was recorded in 2015 which represented the amount of the unearned premium reserve at the Merger date.

12. Other charges

	2016 $'000	2015 Restated $'000
Corporate oversight costs	3,180	7,961
Continental Europe Office closure costs	3,157	–
Acquisition service awards	1,664	–
Amortisation of goodwill (Note 15)	1,545	1,545
Share based compensation*	–	8,892
Impairment expense on owner occupied land and buildings	–	583
	9,546	18,981

The 2015 Other charges was restated to reflect reclassification of foreign exchange gains on revaluation of monetary items other than investments separately in Profit and Loss account.

*Share based compensation

As a component of the compensation plan for senior management, certain employees held share options and restricted share awards and units in TMHCC, the ultimate holding Company. This plan closed on 27 October 2015 as a result of the acquisition of the HCC Group by TMHD resulting in accelerated vesting and cash payment of all share options and restricted share awards.

13. Exceptional items

	2016 $'000	2015 $'000
Revaluation gain / (Impairment expense) on investment in subsidiary undertakings	–	(8,233)

The book value of HCC Diverificación y Soluciones S.L., a subsidiary of the Company, decreased below the original cost and an impairment totalling $0.045m was recorded in the Profit and Loss account in 2015. In 2016 the subsidiary was revalued giving rise to a revaluation gain recognised in the Profit and Loss account.

The Company historically valued its investment in HCCE at fair value which was equivalent to net book value. In 2015, the net book value decreased below the original cost causing an impairment expense booked in the Profit and Loss account totalling $8.23m. After revaluation of investment, HCCE was merged into the Company's operation on 1 April 2015 (Note 11) thus eliminating the investment in subsidiary undertaking of the Company onwards.

14. Tax on profit on ordinary activities

	2016 $'000	2015 $'000
UK Corporation tax at 20.0% (2015: 20.25%)		
Current tax on income for the year	22,566	16,615
Tax payments in respect of prior years	(121)	1,578
Current tax charge for the year	22,445	18,193
Deferred tax – origination and reversal of timing differences	16,418	141
Tax on profit on ordinary activities	38,863	18,334

The tax assessed for the year is higher (2015: higher) than the standard rate of corporation tax in the UK. The differences are explained below:

	2016 $'000	2015 $'000
Profit on ordinary activities before taxation	176,961	59,562
Tax on profit on ordinary activities at standard rate of 20.0% (2015: 20.25%)	35,392	12,061
Exceptional item which has no tax effect	–	1,667
Expenses not deductible for tax purposes	337	357
Amortisation of goodwill	386	313
Deferral of taxation on release of Equalisation Reserve	(16,038)	–
Depreciation of capital allowances in excess	(25)	168
Tax payments in respect of prior years	(121)	1,578
Effect of foreign exchange	2,397	2,055
Other	117	(6)
Current tax charge for the year	**22,445**	**18,193**

The calculation of deferred tax balances at the year end takes into account the reduction in the UK main corporation tax rate from 20% to 19.0% that will be effective from 1 April 2017 and to 17.0% that will be effective from 1 April 2020.

15. Goodwill

	2016 $'000	2015 $'000
Cost		
At 1 January	23,176	23,176
At 31 December	**23,176**	**23,176**
Accumulated amortisation		
At 1 January	13,906	12,361
Amortisation charge for the year	1,545	1,545
At 31 December	**15,451**	**13,906**
Net book value		
At 31 December	**7,725**	**9,270**

The goodwill arose on the purchase of a book of Professional Indemnity business from a group Company in 2006.

16. Land and buildings

	2016 $'000	2015 $'000
Leasehold land and buildings	239	239

The investment property, which consists of long leasehold industrial units, was valued by the directors at 31 December 2012 on an open market basis, using reasonable judgements and contemporary evidence available. This valuation of the property has been reflected in these financial statements. See Note 3.l.

17. Investment in subsidiary undertakings

The movement in the revaluation of subsidiary undertakings is summarised below:

	2016 $'000	2015 $'000
At 1 January	7,501	44,633
Distributions received from subsidiary undertakings	–	(32)
Revaluation of subsidiary undertakings	2,058	948
Impairment expense	–	(8,233)
Effect of Merger (Note 13) and dissolution of subsidiary undertakings	–	(29,570)
Foreign exchange impact on translation to closing rate	(1,351)	(245)
At 31 December	8,208	7,501

The directors believe that the carrying value of the Company's investment in subsidiary undertakings is supported by the underlying net assets.

Investment in its subsidiary undertakings, as listed below, comprises its equity holdings at current net asset value, less any impairment.

Name	Principal activity	Class of shares	Effective%
HCCI Credit Services Limited	Information services provider	Ordinary	100%
HCC Diversificación y Soluciones S.L. (incorporated in Spain)	Dormant	Ordinary	100%

All subsidiary companies are directly held and are incorporated in England and Wales unless otherwise stated above. The registered office for HCCI Credit Services Limited is The Grange, Rearsby, Leicester LE7 4FY and the registered office for HCC Diversificación y Soluciones S.L. is Plaza de Colón 2, Torre de Colón, Torre 1, 3ª Planta, Madrid 28046, Spain.

18. Other financial investments

	Fair value or amortised		Book cost	
	2016 $'000	2015 $'000	2016 $'000	2015 $'000
Variable yield securities and units in unit trusts	32,520	19,544	32,520	19,544
Debt securities and other fixed-income securities	1,000,673	972,881	1,038,013	924,344
Equity shares	77,005	70,470	74,228	71,709
	1,110,198	1,062,895	1,144,761	1,015,597

Debt securities and other fixed-income securities comprise listed investments.

19. Other debtors

	2016 $'000	2015 $'000
Other debtors	39,400	42,291
Deferred tax asset	–	73
Amounts owed by group companies	10,894	19,406
	50,294	61,770

There are no debtors falling due after more than one year. Amounts owed by group undertakings are short term, unsecured, interest free and have no fixed date of repayment.

2015 was restated to reflect reclassification of certain Debtors arising out of reinsurance operations to Other debtors.

20. Tangible assets

	Owner occupied Leasehold improvements $'000	Owner occupied Land and Buildings $'000	Computer equipment $'000	Fixtures, fittings and office equipment $'000	Total $'000
Book cost					
At 1 January 2016	1,466	3,549	19	1,827	6,861
Additions	–	23	–	–	23
Valuation adjustment	–	–	–	–	–
Disposals	–	–	–	–	–
Foreign exchange impact of translation to closing rate	–	–	–	3	3
At 31 December 2016	**1,466**	**3,572**	**19**	**1,830**	**6,887**
Accumulated depreciation					
At 1 January 2016	1,466	839	19	1,812	4,136
Charge for the year	–	61	–	6	67
Disposals	–	–	–	–	–
At 31 December 2016	**1,466**	**900**	**19**	**1,818**	**4,203**
Net book value					
31 December 2016	–	**2,672**	–	**12**	**2,684**
31 December 2015	–	**2,710**	–	**15**	**2,725**

Land and buildings is occupied by the Company for its own use and is being depreciated over 50 years through June 2045.

21. Called up share capital

	2016		2015	
Allotted, called up and fully paid Ordinary Shares	**Number of Shares**	**$'000**	**Number of Shares**	**$'000**
Balance brought forward:				
– Ordinary shares of £1 each	96,047,813	163,045	96,047,813	163,045
– Ordinary shares of $1 each	61,360,000	61,360	61,360,000	61,360
Shares issued during the year:				
– Ordinary shares of $1 each	8,837,000	8,837	–	–
Balance carried forward	**166,244,813**	**233,242**	**157,407,813**	**224,405**

The £1 ordinary shares are translated to US Dollars at the rates of exchange ruling on the dates the shares were issued.

Dividends declared as payable in 2016 totalled $nil (2015: $8.7m).

22. Other creditors including taxation and social security

	2016 $'000	2015 $'000
Corporation tax	2,567	4,088
Deferred tax liability	16,345	–
Other creditors	267	723
Amounts owed to group companies	29,071	22,219
	48,250	**27,030**

Amounts owed to group companies are short term, unsecured, interest free and have no fixed date of repayment.

Deferred tax liability/(asset)	2016 $'000	2015 $'000
At 1 January – deferred tax asset	(73)	(214)
Changes in accelerated capital allowances	190	67
Deferred taxation of release of Equalisation provision	15,236	—
Short-term timing differences	992	74
At 31 December - deferred tax liability/(asset)	**16,345**	**(73)**

The deferred tax liability/(asset) consist of the following amounts:

Deferred tax liability/(asset)	2016 $'000	2015 $'000
Accelerated capital allowances	158	(32)
Short-term timing differences	951	(41)
Deferred taxation for release of Equalisation provision	15,236	—
Deferred tax liability/(asset)	**16,345**	**(73)**

23. Capital commitments

There were no capital commitments contracted for but not provided for at 31 December 2016 (2015: $nil).

24. Ultimate parent Company and controlling party

The Company's ultimate parent Company is Tokio Marine Holdings, Inc. ('TMHD'). TMHD is incorporated in and its head office is located in Tokyo, Japan. Copies of the consolidated financial statements of TMHD can be obtained from its website at www.tokiomarinehd.com/en/ir/library/annual_report/

25. Subsequent events

On 27 February 2017, the Lord Chancellor reduced the Ogden rate from 2.5% to -0.75%. The Ogden rate represents the discount rate used to discount future compensation payments net of inflation to ensure claimants are adequately compensated for future inflation. This rate is the discount rate that is applied for lump sum awards in the UK for bodily injury claims. Reducing the Ogden rate results in the present value of lump sum awards being higher and therefore increases the cost for insurers.

The Company's management conducted an analysis and has determined that effect of this change on these financial statements is immaterial.

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TOKIO MARINE HCC

To Be a ***Good Company***